LOOKING BACK AND FOREWORD

by Steve Brown

The 4th of July is upon us so why not hold an ol' fashion picnic and fireworks celebration? Food poisoning and salmonella are a couple reasons, not to mention the threat of fire, arrest for the illegal fireworks and stares from your "green" neighbors when you spew more smoke than Union Carbide. Regardless of how you are going to celebrate it you have to admit that the 4th of July has changed over the past 10Ys.

If we look forward, there is no telling what the 4th of July will bring. For banking, however, we have a clearer picture. 10Ys from now, banking too will be a different place: 23% percent of our readers will be retired, 20% will not be working in banking, and 7% will be running a new bank. There will be 17% fewer banks and 30% fewer branches. Those banks and branches that do exist will be smaller. Credit margins will be skinnier, driven down by greater competition from financial institutions and customers that are more transient and interest rate sensitive. Operating expenses will be reduced slightly, due to greater use of credit scoring, electronic loan processing, imaging and more efficient core banking. Net interest margins will be slimmer, however, fee income will be higher. While operating margins will be smaller, banks will have a better handle on risk and produce a greater return on risk adjusted capital.

The important question is where will your bank be in 2018? One of the best management exercises is to develop a 10Y plan (not just a 5-year) and work backwards about what it means in terms of capital, employees, distribution channels, products, footprint, competitive position and key strategic priorities. Can your bank make it on its existing product set? In what areas should those new products and services be developed? How many branches do you need and where? Decisions on staffing, corporate organization (stay private or go public?) and new business lines can be implied by a bank's future goals.

One needn't be a futurist to come up with answers to the questions about how the bank will look in terms of assets, capital and earnings. In fact, if you think your bank will look the same, only bigger in 10Ys, chances are you're missing something and not being innovative enough. The goal of this exercise is to not name exact products, but to identify areas of growth. The exercise of 10Y planning starts with crafting a set of goals (asset size, geography, branch network, etc.) and then rank their relative importance. Is market share more important than growth? What about the trade-off between growth and earnings? Once targets are identified, the team can then work backwards to identify 7, 5, 2 and 1Y goals.

While 5Y plans are common, the time frame is too short for many managers, as it usually takes 3-5Ys for a new product to be rolled out and accepted. Further, most managers can almost taste 5Y targets, whereas 10Y goals allow for greater vision and bigger dreams. The current trend of producing a 10Y plan dovetails nicely to the latest trend in asset-liability management - producing "going concern value." Traditionally, banks have looked at the ALM position of their current balance sheet, without asking the question of what is the risk, once current assets and liabilities mature. In other words, going concern value treats a bank not as a portfolio of assets and liabilities, but rather one of a series of growing earnings and risk streams.

Focusing 10Ys into the future highlights what bank managers can do today (in terms of business direction, infrastructure and brand) to ensure adequate shareholder return in the future. They say that a journey of 1,000 miles starts with a single step. That said, it is always helpful to know where you are going first.

On our nation's 232rd birthday, we are thankful that we have the freedom to plan 10Ys into the future and char our hotdogs as black as we want them. Have a happy 4th and good luck with the grill.

BANK NEWS

July 4th

According to our calculations, the cost of a 4th of July picnic is up 8% due to higher food costs over last year.

Jobs

In June, the U.S. private-sector cut 79k jobs, compared to a 25k gain in May.

Pin Problem

Hackers have stolen ATM PINs by infiltrating the channel between Citibank's 7-Eleven ATMs and back-end computers used for processing. The breach may have occurred through the installation of malicious software within the banking server to catch PINs flowing through the channel or by gaining administrative access to the network. This breach may be related to another string of scams linked to a Citi branch in Manhattan where $180K was withdrawn from copied cards.